EB-2021-0212

IN THE MATTER OF the *Ontario Energy Board Act, 1998*, S.O. 1998, c. 15, (Schedule B);

AND IN THE MATTER OF a proceeding commenced by the Ontario Energy Board on its own motion to consider the values of the inflation factors to be used in rate adjustment applications for rates effective in 2022

REPLY SUBMISSIONS BY THE COALITION OF LARGE DISTRIBUTORS

October 15, 2021

SECTION 1: INTRODUCTION

In accordance with Procedural Order No. 1 ("PO#1"), the Coalition of Large Distributors ("CLD") filed its submissions in this proceeding on October 1, 2021 ("October 1st Submissions"). Submissions were also filed by OEB Staff, Association of Major Power Consumers in Ontario ("AMPCO"), Consumers Council of Canada ("CCC"), Electricity Distributors Association ("EDA"), London Property Management Association ("LPMA"), School Energy Coalition ("SEC") and Vulnerable Energy Consumers Coalition ("VECC").

In this reply to the submissions filed by OEB Staff and other parties, the CLD will continue to use terminology from its October 1st Submissions. In particular, the CLD will continue to use the terms Option 1, Option 2 and Option 3 to refer to the three options set out in PO#1 and in the OEB's Notice.

In view of the submissions made by some parties, the CLD will provide introductory comments about the scope of this proceeding that will set the context for its reply submissions.

The OEB explicitly indicated that this proceeding will focus solely on determining the values for 2022 inflation factors.[1] It seems clear that the OEB deliberately and purposefully initiated a proceeding to consider only options for 2022 and not to consider multi-year proposals or suggestions. Yet some parties condition their proposals on a multi-year approach. SEC, for example, says that any decision the OEB makes for 2022 must be maintained for 2023 and 2024; if not, there will be unfairness to either ratepayers or utilities.[2] The proposals made by SEC and other parties that are conditioned on what will happen in years beyond 2022 should only be considered by the OEB in the context of addressing the inflation factor over a multi-year period, but multi-year approaches to the inflation factor are clearly outside the scope of this proceeding.

The central thrust of the CLD's October 1st Submissions was the importance of a principles-based approach in this proceeding. As discussed below, OEB Staff has made similar submissions in favour of a principles-based approach. The OEB Staff Submission ("Staff Submission") also refers to important regulatory principles and says that the OEB should weigh the benefits of regulatory predictability, consistency and efficiency against the modest bill changes ratepayers would experience if the inflation factors were changed.[3]

OEB Staff has recognized that a fundamental issue in this proceeding is whether modest bill changes justify a deviation from the principles that guide the OEB's establishment and application of ratemaking frameworks. In other words, principles of regulatory predictability, consistency and efficiency must be considered together with materiality. The CLD notes that the incremental total bill impact associated with Option 1 is roughly 0.2%, as calculated by OEB Staff and set out in the Fact Sheet attached to PO#1.

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[1] PO#1, page 3.
[2] SEC submissions, page 1.
[3] Staff Submission, page 6.

The CLD submits that the modest bill changes referred to by OEB Staff are not material and do not outweigh the benefits of regulatory predictability, consistency and efficiency. In the following section of these submissions, the CLD will elaborate on this point as it replies to submissions made by others about the three options identified by the OEB, as well as other suggested options.

SECTION 2: OPTIONS

Option 1

As stated in the Staff Submission, the OEB has a well-established policy and methodology for calculating the inflation factor for incentive rate applications for formulaic annual rate adjustments.[4] The Staff Submission notes in particular the *Report of the Board on Rate Setting Parameters and Benchmarking under the Renewed Regulatory Framework for Ontario's Electricity Distributors* ("Report") that was issued on November 21, 2013 in EB-2010-0379.[5]

The Staff Submission refers to options that represent "a departure from OEB policy as established in the Report" and it goes on to say that the OEB will wish to give careful consideration to whether "a departure from the OEB's well-established policy (i.e., a departure from option 1)" is warranted at this time.[6] Thus, the Staff Submission recognizes that anything other than Option 1 would be a departure from OEB policy as established in the Report.

Later, the Staff Submission addresses the basis upon which the OEB might consider a deviation from established policy. The Staff Submission notes that:

> *…policy documents serve an important function by providing guidance to stakeholders regarding how the OEB intends to deal with certain recurring situations. They promote regulatory predictability, consistency, and efficiency for … regulated firms, ratepayers, and other stakeholders.*[7]

The Staff Submission says that, as a general matter, OEB panels will apply OEB policies unless there is a good reason that they should not do so. OEB Staff submits that the starting point for this proceeding is the Report and that, absent "a principled basis for deviation from this policy" the OEB should continue to apply the inflation factors as set out in the Report.[8]

In line with OEB Staff's submission about a "principled basis", the CLD discussed the importance of a principles-based approach in its October 1st submission.[9] The EDA also highlighted the importance of a principled decision-making process in its submissions.[10]

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[4] Staff Submission, page 18.
[5] Staff Submission, page 1.
[6] *Ibid*.
[7] Staff Submission, page 5.
[8] *Ibid*.
[9] See, for example, October 1st Submission, pages 2 and 5-6.
[10] EDA submissions, pages 3 and 4.

The CLD submits that there is no principled basis for a deviation from established OEB policy in this proceeding. A change to the OEB's methodology for determining the value of the inflation factor so as to impact bills in a way that is not material does not justify any deviation from established policy.

Submissions by many parties in this proceeding have focused narrowly on the AWE index and the composition of the labour component of the OEB's inflation factor.[11] These narrowly-focused submissions do not address two important considerations.

First, as stated by Statistics Canada, the increase in AWE in May of this year over February of 2020 "reflects a number of factors".[12] There has been no attempt in this proceeding to disaggregate these factors or to come to an understanding of the relative impact of each factor.

Second, the focus on the labour component of the inflation factor in this proceeding has drawn attention away from a core consideration, namely, the extent to which utilities can expect to be faced with inflationary cost pressures in 2022. Utilities have been experiencing heightened materials input costs due to shortages and supply chain and logistics challenges. Nothing on the record of this proceeding supports a finding, or an assumption, that these cost pressures will lessen or disappear in 2022.

More generally, OEB Staff makes a number of observations about increased levels of inflation that are impacting the Canadian economy. OEB Staff points out that Statistics Canada, "in its issuances of monthly CPI data beginning around the middle of 2021", has "routinely" noted higher inflation.[13] OEB Staff goes on to say that CPI has "continued to rise well above the 3% upper bound of the Bank of Canada's nominal range".[14] While CPI is not a good substitute for utility input costs, it does reflect the inflationary pressures that are present in the economy. Indeed, the Staff Submission recognizes the "risk and uncertainty posed by current trends in inflation statistics like CPI".[15] Without having delved into these inflationary matters more fully, a deviation from existing policy may well end up unfairly underfunding prudently incurred costs at a time when there are already higher levels of uncertainty around where input costs will go in 2022.

In its submissions, AMPCO has captured the point that a full review and evaluation of input costs is required if the 2022 inflation factor is to be re-considered, or alternatively that a single factor review is inappropriate. As stated by AMPCO:

> *The GDP (GDP-IPI) component of the calculation measures price changes of goods and services purchased by households and government (the expenditure side of the GDP), plus capital equipment. There is no doubt that COVID-19 will have an impact on this non-labour*

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[11] See, for example, SEC's submissions, as discussed below on page 8.
[12] The Daily, Statistics Canada, July 29, 2021.
[13] Staff Submission, page 10.
[14] Staff Submission, page 11.
[15] *Ibid*.

input and simply adjusting only the labour component to attempt to compensate for the impacts of COVID-19 is heavy handed and will not yield appropriate results.[16]

LPMA submits that, if Option 1 is adopted, the OEB should take the "higher inflation factor" into consideration when it comes to clearance of COVID-19 account balances.[17] However, this proceeding is not the forum for the OEB to consider how COVID-19 account balances should be cleared. A determination about how the COVID-19 account balances should be disposed of will be made when the accounts come to be cleared, based on the evidence before the OEB at that time. The OEB should not attempt to pre-determine in this proceeding matters relating to the clearance of the balances in the accounts.

This proceeding and the OEB's future consideration of the clearance of COVID-19 account balances are two fundamentally different matters. In this proceeding, the OEB is considering the inflation factor that will apply in a future year, 2022, on the basis of currently available evidence that informs expectations about inflation for that year. The clearance of COVID-19 account balances will involve consideration of financial impacts recorded in the accounts that, as of that time, will actually have occurred. And, in any event, the means test that is part of the OEB's guidance regarding the treatment of COVID-19 accounts will implicitly recognize incremental revenue associated with a "higher inflation factor".

The current state of considerable uncertainty about inflation for 2022 makes this a very difficult and inopportune time to try to fine-tune the OEB's 2022 inflation factor. It is particularly inopportune to do so given that, as stated by OEB Staff, the bill impacts of a change are modest. Further, to the extent that the driver for change is based on reduced numbers of below-average wage earners in the workforce, it is to be expected that this reduction will correct itself as lower-wage workers re-enter the workforce. To the extent that the driver is primarily the result of other factors causing sustained changes in the labour force, it will become even more clear in the future that, at this time, there is not sufficient information to provide a basis for re-setting the inflation factor.

The OEB's current ratemaking frameworks have been among the OEB's most durable methodologies over time. As noted in the October 1st Submissions, these frameworks were designed to include features that accommodate variability and protect customers. If modest bill changes are accepted as the basis for a re-set of one element of the well-established regulatory methodology, the durability and predictability of the OEB's methodologies is thrown into doubt.

The CLD agrees with the EDA's submissions regarding the benefits of preserving the stability and predictability of rate-making methodologies.[18] But, if a well-established methodology is subject to re-opening due to circumstances that result in modest bill impacts, then there is no basis to expect that the OEB's methodologies can or will maintain any stability or predictability over time.

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[16] AMPCO submissions, page 3.
[17] LPMA submissions, page 3.
[18] EDA submissions, page 3.

For these reasons, and the other reasons set out in the CLD's October 1st Submissions, the OEB should adopt Option 1.

Options 2 and 3

OEB Staff supports either of Options 1 or 3, but not Option 2.[19] No intervenor has expressed any support for Option 2. The CLD has already submitted that the OEB should disregard Option 2.[20] Given that no submissions have been made in favour of Option 2, the CLD reiterates its position that this option should be disregarded.

While, in addition to OEB Staff, SEC supports Option 3, this option was criticized by a number of other intervenors. CCC takes no position on Option 3, yet even CCC says it is unclear if there is a more appropriate sub-index that is more representative of labour inflation expected to be experienced by utilities in 2022.[21] The CLD notes that even at the time the current 2-factor inflation factor method was chosen, PEG included a statement of its opinion about the use of the AWE index:

> *PEG believes the best generic and off-the-shelf labor price index to use in our input price and TFP research is average weekly earnings (AWE) for all workers in Ontario.*[22]

VECC is one of the parties that criticized Option 3. VECC says that "the option with the least appeal" is a search for a wage sub-index that may (or may not) be less affected by composition effects. Further, VECC submits that it is questionable whether any wage index can be abstracted from the labour market disruptions occurring during the pandemic.[23]

According to LPMA's submissions, the "major problem" with Option 3 is that there is no clear indication of what labour inflation is expected to be experienced by distribution and transmission utilities in 2022, or in the economy as a whole.[24]

In its discussion of Option 3, AMPCO submits that it does not support the targeted adjustment of only one of the inputs to the inflation factor calculation by using sub-indices of AWE and AHE. AMPCO's view is that there is little precedent for making such an adjustment to a single input factor. Further, AMPCO says that to assume that COVID-19 has only affected the labour

[19] Staff Submission, page 18.
[20] October 1st Submissions, page 7.
[21] CCC takes no position on Option 3 and says: "It is unclear from our perspective if there is a more appropriate sub-index that is more representative of labour inflation expected to be experienced by utilities in 2022." See CCC submissions, page 2.
[22] "Productivity and Benchmarking Research in Support of Incentive Rate Setting in Ontario: Final Report to the Ontario Energy Board", November 5, 2013, page 19.
[23] VECC submissions, page 4.
[24] LPMA submissions, page 5.

component of the calculation is overly simplistic "and will likely result in incorrect inflation factors".[25]

In common with AMPCO, the CLD does not support the "targeted adjustment" of only one of the inputs to the calculation of the 2022 inflation factor. Indeed, the uncertainties referred to by VECC, LPMA and AMPCO are one of the reasons why, in current circumstances, and given the lack of a full or even adequate evidentiary record, the CLD submits that the OEB should not attempt at this time to make any change in the methodology for determination of the inflation factor.[26]

As for AMPCO's point that it is overly simplistic to assume that COVID-19 has only affected the labour component of the inflation calculation, the CLD's October 1st Submissions addressed broader inflationary pressures[27] and the current uncertainty about whether recent increases in inflation will persist or be transitory.[28] In a similar vein, OEB Staff says that concerns are being raised about the level of inflation and whether it is transitory.[29]

OEB Staff also submits "it is foreseeable" that the decision made in this proceeding could have ripple effects into future years. OEB Staff expands on this submission with the following comments:

> *For example, the duration and extent of COVID impacts on society and in the economy, in particular, the labour force are not fully materialized or understood. There is a myriad of potential outcomes such as a full recovery that aligns with pre-pandemic recovery, or a recovery that contains a permanent shift in the labour force. As the pandemic continues, the state of the economy, labour force and inflationary pressures continue to evolve.*[30]

The CLD submits that a change to the methodology for determining the value of the inflation factor should not be made in these circumstances where the duration and extent of COVID impacts are not fully materialized, or even understood, and inflationary pressures continue to evolve. Far from supporting regulatory predictability, an attempt to make a change due to impacts that are not understood, and inflationary pressures that are still evolving, casts uncertainty on the OEB's regulatory models, processes and outcomes.

VECC submits that this is not an appropriate time or forum for the OEB to consider the "more esoteric arguments" around the value of using AWE and AHE or any other labour sub-indices.[31] VECC makes reference to the OEB "planning to revisit the entire question of inflation factors at some later point and once the long term impacts of the pandemic become clearer".[32] LPMA says

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25 AMPCO submissions, page 3.
26 October 1st Submissions, pages 6-7.
27 *Supra*, page 4
28 *Supra*, page 6.
29 Staff Submission, page 11.
30 Staff Submission, page 6.
31 VECC submissions, page 5.
32 *Ibid*.

that changes in the labour component of the formula should only be done as part of a "comprehensive review" of alternative indices.[33]

The points made by VECC and LPMA about this not being an appropriate time or forum to consider changes in the labour component of the inflation factor apply equally, if not more strongly, to the overall inflation factor methodology. Just as this is not an appropriate time or forum to consider changes to the labour component, this is not the appropriate time or forum to change the methodology for calculating the inflation factor. As noted by the EDA, the methodology was established in the EB-2010-0379 proceeding, which was "resourced very differently" from this one, including as it did extensive consultation with stakeholders and expert advice.[34] Further VECC's point that the OEB should wait until the ongoing impacts of the pandemic become more clear before revisiting the "entire question" of inflation factors actually supports the conclusion that the OEB should not attempt an ad hoc review of the methodology at this time.

In its submissions, SEC is singularly focused on its perception of the impacts of the annual change in AWE between 2019 and 2020. SEC submits that the growth in the AWE index "appears" to be "entirely driven" by the composition of the labour force.[35] But OEB Staff observes, with respect to the impact of COVID-19 restrictions on the make-up of the active labour force, that there is no easy way to directly disentangle the impact this has on AWE from the data published by Statistics Canada.[36]

SEC's submissions pay little regard to the risks, uncertainties and inflationary impacts caused by the pandemic that are affecting utilities. While it is true that SEC refers very briefly to utility sub-indices of the AWE index, LPMA makes clear that these sub-indices do not yield reliable information. As stated by LPMA, Statistics Canada generally recognizes that the quality of the data used for the utilities sector is less than it is for the industrial aggregate. LPMA gives actual examples of the remarkable volatility in the Ontario utilities inflation factor and it says that the OEB should avoid the use of sector specific inflation rates for utilities, whether in aggregate or split out for gas and electricity utilities.[37]

The fact that SEC pays little regard to broader implications of the pandemic is a reflection of the overall approach taken in SEC's submissions. Rather than offering a principled approach to the OEB's consideration of the 2022 inflation factor, SEC fixes on the change in AWE, taken in isolation, as a basis to justify an outcome. However, as indicated by OEB Staff, a principled approach to this proceeding involves weighing important regulatory principles. SEC's submissions give no weight to the benefits of predictability, consistency and efficiency referred to by OEB Staff and SEC's submissions make no attempt to balance relatively modest bill changes against these principles.

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[33] LPMA submissions, page 3.
[34] EDA submissions, page 4.
[35] SEC submission, page 2.
[36] Staff Submission, page 8.
[37] LPMA submissions, page 5.

In short, Option 2 is not supported in any of the submissions made in this proceeding and, across the range of submissions, the grounds for criticism of Option 3 far outstrip the support for this alternative. The CLD submits that the OEB should not adopt either of Options 2 or 3.

Other Suggested Options

OEB Staff says it has not identified other "reasonable options" beyond the three options identified in PO#1.[38] But other options have been brought forward by intervenors.

One suggested option is that the OEB "revert" to the approach it used for 2007-2013.[39] This suggestion involves the use of the Gross Domestic Product Implicit Price Index for Final Domestic Demand ("GDP-IPI (FDD)") that was a one-factor inflation factor in the OEB's 2nd and 3rd generation incentive rate-setting mechanisms.[40].

In the Report, the OEB outlined its decision to move away from using the GDP-IPI (FDD) as a one-factor inflation measure, noting that GDP-IPI (FDD) does not provide as good an indication of Ontario price fluctuations as the two-factor measure. Further the OEB found that the two-factor measure, comprised of a labour and non-labour element, satisfies the OEB's objectives.[41] The OEB's decision with regard to the use of GDP-IPI (FDD) in the 4th generation rate-setting framework was as follows:

> *The Board finds that the 2-factor IPI is comprised of components that are the best practicable price indices for satisfying its objectives. The 2-factor IPI can be implemented just as easily as the GDP-IPI (FDD), but provides a better indication of Ontario price fluctuations than the economy-wide measure.*[42]

The CLD submits that it would be arbitrary and unreasonable to adopt GDP-IPI (FDD) in this proceeding without any review of - or any basis for the OEB to review - the finding already made by the OEB that GDP-IPI (FDD) does not provide as good an indication of Ontario price fluctuations as the two-factor measure.

If the OEB were to adopt the GDP-IPI (FDD) suggestion, this would mean looking to other regulatory models for one element of the rate-setting methodology that would be incorporated into the current framework. The CLD submits that there is no principled basis for a mix-and-match approach combining elements of different regulatory models, particularly when the purpose of this exercise is to address impacts that do not meet a standard of materiality.

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[38] Staff Submission, page 7.

[39] CCC Submission, page 3.

[40] LPMA submissions, page 2.

[41] In its comments regarding the option of using 100% GDP – IPI (FDD) for the inflation factor (Report, Appendix A, page 1) the OEB said: "Inconsistent with policy direction to better align with more Ontario industry specific inflation."

[42] Report, page 8.

In this proceeding, OEB Staff and parties have brought forward information and data about inflation, and some have offered analyses of data. However, there has been no opportunity for testing of information or analyses, there has been no expert evidence and a full evidentiary record has not been developed. The CLD submits that this proceeding is not the forum for the OEB to over-ride clear and definite findings that it made in the Report.

In fact, the parties who support a simple reversion to a measure of inflation that pre-dated the Report have not provided any evidence to put into doubt the OEB's conclusions about GDP-IPI (FDD). LPMA merely asserts that, unlike the issue raised by the increase in the AWE labour component in 2020, there have been no issues related to the use of GDP-IPI (FDD).[43] The CLD respectfully disagrees. The Report – not to speak of the record of the EB-2010-0379 proceeding – identifies issues with regard to the use of GDP-IPI (FDD). And obviously, when LPMA made its submissions, issues related to the use of GDP-IPI (FDD) had not yet been raised in this proceeding because this approach had not even been identified by OEB Staff as an option for consideration.

In Chapter 2 of the Report, the OEB set out its policies in relation to "a more Ontario-specific inflation factor".[44] The OEB referred to the RRF Report, where it had indicated that it wanted to adopt a more Ontario industry specific inflation factor than the Canadian economy-wide index used in 3rd Generation IR. The OEB also noted that, in the RRF Report, it had set out its intention to select a methodology that would address concerns that were raised in prior consultations regarding inflation factor volatility. The OEB said the appropriate methodology should be guided by the following:

- *the inflation factor must be constructed and updated using data that is readily available from public and objective sources such as, for example, Statistics Canada, the Bank of Canada, and Human Resources and Social Development Canada, and therefore, readily understandable to consumers;*
- *to the extent practicable, the component of the inflation factor designed to adjust for inflation in non-labour prices should be indexed by Ontario distribution industry specific indices; and*
- *the component of the inflation factor designed to adjust for inflation in labour prices will be indexed by an appropriate generic and off-the-shelf labour price index (i.e., not distribution industry-specific).*[45]

In the May 3, 2013 report by Pacific Economics Group ("PEG"), which was commissioned by the OEB to inform the OEB's decisions regarding inflation factors, PEG gave the following summary of the OEB's direction for inflation factors:

[43] LPMA submissions, page 6.
[44] Report, page 5.
[45] Report, page 6.

The inflation factor in the current 3rd Gen IR is the Gross Domestic Product Implicit Price Index for final domestic demand (GDP-IPI). The Board has concluded that a more industry-specific measure of input price inflation will be used as the inflation factor in 4th Gen IR.[46]

Suggestions have also been made about options that are based on blending or smoothing different numbers to arrive at the 2022 inflation factor. While the OEB has considered approaches that smooth rate changes over time, the Report indicated the OEB's preference, insofar as the inflation factor is concerned, for mechanisms that provide more accurate and timely reflections of price inflation.[47] As for the suggestion that data from different indices be blended,[48] there is seemingly no limit to the number of ways in which results from different indices can be combined or blended. In order for any particular approach to be chosen from the virtually unbounded universe of blending options, it would be essential to have full analysis and a solid evidentiary record which, for this purpose, surely would include expert evidence. On the record of this proceeding, there is neither analysis nor evidence to support the selection of any particular blending approach.

SECTION 3: CONCLUSION

OEB Staff submitted that, absent a principled basis for deviation from existing policy, the OEB should continue to apply the inflation factors as set out in the Report. OEB Staff's principled approach is that the OEB should weigh the benefits of regulatory predictability, consistency and efficiency against the modest bill changes ratepayers would experience if the inflation factors were changed. While OEB Staff indicated support for Option 1 or Option 3, there is very little support from other parties for Option 3 and in fact Option 3 has been sharply criticized by some parties.

In response to the OEB's indication that it would consider other options in this proceeding, a simple reversion to GDP-IPP (FDD) has been suggested as an option. But in both the Report and the RRF Report, the OEB made clear its reasons for not using GDP-IPP (FDD) as it moved beyond 3rd generation IR. The record of this proceeding does not provide any basis for the OEB to over-ride the unequivocal findings it made in earlier proceedings involving much more robust, thorough and comprehensive consideration of rate-setting frameworks, including the inflation factor.

There is no doubt that the Canadian economy has been experiencing increased levels of inflation and there is considerable uncertainty about the future course of these inflationary pressures. This is not the time to second-guess what OEB Staff has described as "a well-established policy and

[46] "Empirical Work in Support of Incentive Rate Setting in Ontario", PEG, May 13, 2013, page 6.
[47] Report, Appendix A, page 1
[48] LPMA submissions, page 4.

methodology for calculating the inflation factor",[49] especially without any expert evidence, nor even a full or adequate evidentiary record.

The CLD submits that the modest bill changes referred to by OEB Staff do not out-weigh the benefits of regulatory predictability, consistency and efficiency. On a principles-based approach, Option 1 stands out clearly in the circumstances of this proceeding as the option that the OEB should follow.

If you have any questions regarding any of the comments made herein, please contact the undersigned.

Sincerely,

Michael Lister, MBA, CFA
Acting Vice President, Regulatory Affairs
Alectra Utilities Corporation

cc. Fred Cass, Aird & Berlis.

Michael Lister
Alectra Utilities Corporation
(905) 798-8242
michael.lister@alectrautilities.com

Andrew Sasso
Toronto Hydro-Electric System Limited
(416) 542-7834
asasso@torontohydro.com

April Barrie
Hydro Ottawa Limited
(613) 738-5499 x2106
aprilbarrie@hydroottawa.com

Steve Zebrowski
Elexicon Energy Inc.
(905) 427-9870 x3274
szebrowski@elexiconenergy.com

Stephen Vetsis
Hydro One Networks Inc
(416) 345-6082
Stephen.Vetsis@hydroone.com

[49] Staff Submission page 18.